

IN THE IOWA SUPREME COURT

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No. 16-1974

BEVERLY GARDINER NANCE  
Petitioner-Appellant

v.

IOWA DEPARTMENT OF REVENUE,  
Defendant-Appellee

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APPEAL FROM THE IOWA DISTRICT COURT  
FOR POLK COUNTY  
HON. MICHAEL D. HUPPERT, JUDGE

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**APPELLANT'S FINAL BRIEF  
AND REQUEST FOR ORAL ARGUMENT**

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## STATEMENT OF ISSUES PRESENTED FOR REVIEW

### **WHETHER THE DISTRICT COURT ERRED WHEN IT DECLARED THAT FAMILY SETTLEMENT AGREEMENTS CAN NEVER AFFECT INHERITANCE TAX CONSEQUENCES.**

#### ***Cases***

In the Matter of the Estate of Bliven, 236 N.W.2d 366, 369 (Iowa 1975)

In Estate of Van Duzer, 369 N.W.2d 407 (Iowa 1985)

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Matter of Guardianship of Collins, 327 N.W.2d 230, 233 (Iowa 1982)

#### ***Statutes***

Iowa Code § 450.3 (2009)

Iowa Code § 450.9 (2009)

Iowa Code § 633.810(1) (2003)

Treas. Reg. § 20.2056(e)-2(d)(2); 26 CFR 20.2056(e)-2(d)(2)

## **STATEMENT OF THE CASE**

### **PROCEDURAL BACKGROUND**

Petitioner-Appellant, Beverly Gardiner Nance, filed an amended inheritance tax return seeking a refund of \$10,034.00. App. 3-22. The Iowa Department of Revenue (“**DOR**”) denied the refund claim. App. 82. Petitioner-Appellant filed a protest. App. 1-2. Upon hearing, the Administrative Law Judge (“**ALJ**”) held that a settlement agreement between Petitioner-Appellant and the Estate of Lester D. Gardiner, Sr. had “no bearing” on the inheritance tax owed by Petitioner-Appellant. ALJ Ruling. The Petitioner-Appellant appealed to the Director of DOR who affirmed the ALJ’s ruling. Director’s Ruling. The Petitioner-Appellant timely appealed to the Iowa District Court for Polk County where the Honorable Michael D. Huppert affirmed the Director of DOR’s ruling. District Court Ruling.

### **PRESERVATION OF ERROR**

Upon the entry of the Honorable Michael D. Huppert’s ruling, Petitioner-Appellant filed a timely Notice of Appeal, thereby preserving her right to appeal all of the issues raised herein.

### **FACTUAL BACKGROUND**

On January 31, 2009, Lester D. Gardiner, Sr. (“**Decedent**”) died at the age of 97. App. 3-22. He designated his surviving daughter-in-law, Beverly Gardiner Nance (“**Taxpayer**,” also Petitioner-Appellant) as sole beneficiary of his Edward D. Jones brokerage accounts (“**Accounts**”). The circumstances surrounding Decedent’s

designation of Taxpayer as beneficiary of the Accounts are at the heart of this controversy.

Decedent had one son, Lester, Jr., who preceded him in death on June 16, 2007. App. 54. Lester, Jr. was married twice. App. 54. He had three children by his first wife, whom he divorced. App. 54. These three children were the primary beneficiaries of Decedent's estate. App. 1-2. Lester, Jr., married Beverly, the Taxpayer, in 1979. App. 54. They had no children together. App. 54.

On August 17, 2003, Decedent executed a change of beneficiary form to the Accounts naming his son, Lester, Jr., as primary beneficiary, and Taxpayer as contingent beneficiary (the "**Beneficiary Form**"). App. 23-27. Because Lester, Jr. predeceased Decedent, Taxpayer was the sole beneficiary. App. 54. Taxpayer had no knowledge of this transaction at the time it occurred. App. 41-42.

On May 28, 2009, Decedent's estate filed a lawsuit against Taxpayer challenging the validity of the Beneficiary Form that named Taxpayer the sole beneficiary of the Accounts. App. 55-62. The Decedent's estate *inter alia* alleged that the Decedent lacked the capacity to execute the Beneficiary Form. App. 55-62.

On October 20, 2009, Decedent's estate timely filed the inheritance tax return and paid a tax of \$18,988.00. App. 3-22. This inheritance tax was paid as if Beverly had inherited the entire proceeds of the Accounts at issue.

As the litigation progressed, Decedent's estate had the medical and nursing home records of Decedent and Decedent's wife, Mildred, some 2,800 pages, reviewed by Dr. Robert Bender of the Johnny and Ronnie Orr Memory Center. App. 63-64. Dr. Bender opined that both Decedent and Mildred suffered from dementia. App. 63-64. For

example, the records indicated that Decedent tried to iron his clothes with a call light and was incapable of understanding his financial information or the consequences of any changes made. App. 63-64.

The suit brought by the Estate against Taxpayer was based in part upon the allegation that Decedent lacked the requisite mental capacity to execute the Beneficiary Form. App. 55-62. This contention was supported by the Bender letter. App. 63-64. Taxpayer could not find an expert that would opine to the contrary. App. 65-68. With no substantive defense, Taxpayer believed that the Dallas County District Court would likely hold that the Beneficiary Form would be held void for the reason of Decedent's lack of mental capacity to execute the same. App. 69-72.

On July 27, 2010, Decedent's Estate and Taxpayer entered into a Family Settlement Agreement (the "**Settlement**") (App. 69-72) agreeing that the Accounts' assets be liquidated and the proceeds divided equally between Decedent's Estate and Taxpayer. The proceeds from the Accounts, which were available to be paid out to the parties under the Settlement, were reduced by the inheritance tax previously paid on these amounts. The parties agreed that any refund of inheritance taxes would be divided equally between the Estate and Taxpayer. On September 3, 2010, Dallas County District Court approved the Settlement.

Beverly's motives for entering into the Settlement were not based on any effort to evade or reduce state inheritance tax, but rather to resolve a genuinely disputed claim.

Beverly entered into the Settlement in good faith to resolve a genuine dispute that she likely would have lost, and not for any purpose of avoiding taxes. The Iowa Department of Revenue (the "**DOR**") does not challenge Beverly's motives; had she lost



at trial, she would have received no part of the Accounts, and **no** tax would have been owed. DOR's Reply to Taxpayer's Resistance to DOR's MSJ, Response 7.

On October 28, 2010, Decedent's estate filed an amended tax return requesting a refund in the amount of \$10,034.00 reflecting the revised distribution of the Accounts' assets, as agreed upon in the Settlement. Decedent's estate claimed that those assets passing through the estate to Decedent's grandchildren were exempt from tax as property passing to Decedent's lineal descendants.

On November 3, 2010, the DOR denied the refund claim. *See* DOR-28 (App. 82 (Refund Denial)).

On December 29, 2010, Decedent's estate timely filed a Protest challenging the DOR's refund denial. Decedent's estate has since closed, and it has transferred any claims it might have to the refund to Beverly.

The DOR filed an answer on August 28, 2014, almost 4 years later. It raised no affirmative defenses and did not challenge subject matter jurisdiction of the settlement.

These facts are not in dispute.

#### **ROUTING STATEMENT**

This case should be retained by the Supreme Court as this is a case involving substantial issues of first impression as to when a settlement agreement entered into between a taxpayer and a third party should be binding on the Iowa Department of Revenue.

## ARGUMENT

**THE DEPARTMENT AS A MATTER OF LAW MUST RECOGNIZE THE FAMILY SETTLEMENT AGREEMENT (“FSA”) MADE IN GOOD FAITH AND NOT FOR THE PURPOSE OF AVOIDING TAXES AS A VALID INSTRUMENT GOVERNING THE DISTRIBUTION OF DECEDENT'S ASSETS FOR INHERITANCE TAX PURPOSES.**

### *A. Standard of Review*

The issue presented does not involve a matter for fact determination but rather one of statutory interpretation and application. *In the Matter of the Estate of Bliven*, 236 N.W.2d 366, 369 (Iowa 1975) (citing *Estate of Dieleman v. Department of Revenue*, 222 N.W.2d 459, 460 (Iowa 1974)). “Review is de novo.” *Id.*

### *B. Iowa Code Section 450.3 (2009) Imposes Inheritance Tax on Property “Passing” from the Decedent to a Taxable Beneficiary.*

The Iowa Code provides for a tax imposed upon assets “passing” from a decedent to a taxable beneficiary.<sup>1</sup> Lineal descendants of a decedent are exempt from inheritance tax. Iowa Code § 450.9 (2009). Daughter-in-laws are not. The essence of this matter is whether assets from the Accounts “passed” to Decedent’s lineal descendants or to Decedent’s daughter-in-law. The District Court held that family settlement agreements (“FSA”) shall not be considered when determining inheritance tax liability. Ruling on Petition, p. 9. The Iowa Supreme Court says otherwise. In the case of *Estate of Van*

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<sup>1</sup> Iowa Code Section 450.3 (2009) provides, in part, as follows:

450.3 Property included. The tax hereby imposed shall be collected upon the net market value and shall go into the general fund of the state to be determined as herein provided, of any property *passing* as follows:

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3. By deed, grant, sale, gift or transfer made or intended to take effect in possession or enjoyment after the death of the grantor or donor.

*Duzer*, 369 N.W.2d 407 (Iowa 1985), the Iowa Supreme Court held that the property in question "passed" by virtue of the settlement agreement. *Id.* at 410.

In *Estate of Van Duzer*, 369 N.W.2d 407 (Iowa 1985), the decedent executed a revocable trust<sup>2</sup> that gave \$575,000 of assets to taxable beneficiaries to the exclusion of his spouse. *Id.* at 408. The spouse contested the revocable trust in the Iowa probate court claiming that the trust was illusory and failed *ab initio*. *Id.* The spouse and the other parties, but not the Department, entered into a family settlement agreement which resulted in the spouse receiving \$106,500 of the revocable trust assets. *Id.* The Department objected claiming that the spouse must accept her husband's revocable trust under any circumstance. *Id.* at 408-10. The Iowa Supreme Court was satisfied that the spouse's claim that the trust was illusory was an enforceable right under Iowa law and that the controversy between the beneficiaries was truly adversarial. *Id.* at 410. As a result, the Iowa Supreme Court held that the decedent's property *passed* to his spouse under the family settlement agreement (rather than the trust) and thus qualified for a marital exemption. *Id.*; Iowa Code § 450.9 (2009) (providing that spouses are exempt from inheritance tax).

But for the family settlement agreement in *Van Duzer*, all \$575,000 of the revocable trust assets would have gone to taxable beneficiaries and none of the trust assets would have gone to the surviving spouse who was exempt from inheritance tax. The result of *Van Duzer* is conclusive: the Iowa Supreme Court gave effect to a family settlement agreement which dictated the inheritance tax consequences. The District Court erroneously concluded otherwise. Ruling on Petition, p. 9. The District Court

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<sup>2</sup> The decedent's trust was described as an irrevocable inter vivos trust but the decedent retained a general power of appointment which effectively rendered it revocable. *Estate of Van Duzer*, 369 N.W.2d 407, 408 (Iowa 1985).

further erred in holding that the Decedent's estate (on behalf of the Decedent's lineal descendants) did not have an enforceable legal claim against Taxpayer. This is wrong. The Decedent's estate had a very strong cause of action of mental incapacity which it pursued by filing a lawsuit in the Dallas County District Court. Incapacity is a recognized claim in the State of Iowa. *In re Estate of Faris*, 159 N.W.2d 417, 420 (Iowa 1968); *Fairbank State Bank*, 723 N.W.2d 449 (Iowa Ct. App. 2006); *Matter of Guardianship of Collins*, 327 N.W.2d 230, 233 (Iowa 1982). The Iowa Supreme Court in *Van Duzer* did not require that the *enforceable legal right* in question be fully litigated. *Van Duzer* at 410. In fact, the Iowa Supreme Court acknowledged that it had not fully looked into whether the underlying enforceable legal right of the claimant was fully developed and proven, noting:

“While based upon various theories, all aspects of her claim involved the alleged invalidity *ab initio* of the *inter vivos* trust, a circumstance which, if correct, would increase the share passing to the surviving spouse. To the extent the claims of the surviving spouse had merit, it was (a) the duty of the executor to seek return of assets in the possession of the trustees and administer them as estate assets, and (b) the obligation of the trustees to return those assets to the estate.” *Van Duzer* at 410.

Therefore, the District Court erred in holding that the Decedent's estate (the Decedent's lineal descendants) did not have an enforceable legal right to the Accounts.

### **C. The District Court Misinterprets Bliven.<sup>3</sup>**

The District Court cited *In re Estate of Amy C. Bliven*, 236 N.W.2d 366 (Iowa

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<sup>3</sup> *In re Estate of Amy C. Bliven*, 236 N.W.2d 366 (Iowa 1975).

1975) as its authority for the legal proposition that no family settlement agreement can dictate inheritance tax consequences. *Van Duzer*, discussed above, directly contradicts such legal proposition. Nevertheless, *Bliven* involved a family settlement agreement where assets did not “pass” by virtue of the agreement.

In *Bliven*, the decedent tore up her will prior to death. Several charities were beneficiaries in the will and initiated a claim for benefits under the will using a mental incapacity cause of action. *Bliven* at 368. The charities and the heirs entered into a settlement agreement whereby the charities and the heirs split the assets. *Id.* The charities and the heirs stipulated that the will had been revoked. *Id.* In other words, the charities dropped their incapacity claim and cause of action. This is an important fact.

Because the parties stipulated that the decedent died intestate, the Iowa Supreme Court had an easy analysis:

"Clearly, said charities acquired no property right whatsoever by intestate succession from Amy C. Bliven. Consequently, any interest those organizations obtained in property held by decedent at time of her death must have been by conveyance or assignment from decedent's heirs at law."

*Bliven* at 371. The Iowa Supreme Court reasoned that the heirs took title to all the assets under intestate succession and subject to Iowa inheritance tax. The charities received the assets not from the decedent's estate but from the heirs. The parties to the settlement agreement committed an important foot fault. Had they not stipulated that the decedent's will had been revoked, the Iowa Supreme Court in *Bliven* would likely have ruled (as it did in *Van Duzer*) that the decedent's property "passed" to the charities by

virtue of the settlement agreement rather than to the heirs under intestacy.

***D. Under What Circumstances Should a Family Settlement Agreement Control Inheritance Tax Consequences?***

Not every family settlement agreement should control tax consequences. Only when a taxpayer can show four elements should a family settlement agreement control tax consequences: (1) the underlying claim was based on enforceable legal rights of the claimant, (2) the parties to the agreement were truly adversarial, (3) the agreement entered was into in good faith as the result of arm's-length negotiations, and (4) no evidence exists suggesting the agreement was entered into for post mortem tax planning purposes. *Estate of Hubert v. Commissioner*, 101 T.C. 314, 319 (1993), *aff'd*, 63 F.3d 1083 (11th Cir.1995); see also *Estate of Brandon*, 828 F.2d 493 (8th Cir. 1987); *Estate of Bosch*, 387 U.S. 456, 467 (1967).

In *Hubert*, the decedent executed a controversial codicil to his will that divested his spouse of certain rights to decedent's property. *Hubert* at 316. The spouse contested the codicil in the Georgia probate court claiming that other beneficiaries *unduly influenced* her husband to make the change. *Id.* The spouse and the other parties, but not the IRS, entered into a family settlement agreement which resulted in the spouse receiving some of the benefits that the codicil took away. *Id. at 320.* The IRS objected claiming that the spouse must accept her husband's codicil under any circumstance. *Id. at 318.* The Tax Court acknowledged that her claim of *undue influence* was an enforceable right under Georgia state law and that the controversy between the beneficiaries was truly adversarial. *Id. at 320.* As a result, the Tax Court held that the decedent's property *passed* to his spouse under the family settlement agreement (rather than the codicil) and thus qualified for a marital deduction. *Id. at 321.*

In reaching its holding, the Tax Court, most importantly, did not re-litigate the issue of whether the decedent was actually the victim of undue influence. A re-litigation of the state law claim of undue influence in Tax Court would have been redundant given the circumstances as the important parties to the event already hashed out the facts and the appropriate law necessary to resolve the conflict. The Tax Court only needed confirmation that, (1) the underlying claim was based on *enforceable legal rights* of the claimant, (2) the parties to the agreement were truly *adversarial*, (3) the agreement was entered into in *good faith* as the result of *arm's-length negotiations*, and (4) no evidence exists suggesting the agreement was entered into for post mortem tax planning purposes. *Id.* at 319-21.

The IRS will recognize family settlement agreements for estate and gift tax purposes if the agreement represents a *bona fide recognition* of the parties' *enforceable rights*. Treas. Reg. § 20.2056(e)-2(d)(2). The test is virtually identical to *Hubert*.

The facts of the present matter fit squarely into those of *Hubert* and *Van Duzer*. The Decedent (Lester Gardinder, Sr.) executed a change of beneficiary form ("Beneficiary Form") that divested his lineal descendants of certain rights to Decedent's property. (App. 23-37). The lineal descendants contested the Beneficiary Form in the Iowa probate court claiming that the Beneficiary Form was void based on Decedent's incapacity. (App. 55-62). The lineal descendants and the Taxpayer, but not the Department, entered into a family settlement agreement ("FSA") which resulted in the lineal descendants receiving some of the benefits that the Beneficiary Form took away. (App. 69-72). The Department objected claiming that the Taxpayer and lineal descendants must accept the Beneficiary Form under any circumstance. (Letter denying

refund dated November 3, 2010).

In determining whether the FSA controls for inheritance tax purposes, the District Court should follow the analysis prescribed by the Tax Court and the Iowa Supreme Court: (1) was the underlying claim based on *enforceable legal rights* of the claimant, (2) were the parties to the agreement truly *adversarial*, (3) was the agreement entered into in *good faith* as the result of *arm's-length negotiations*, and (4) whether any evidence exists suggesting the agreement was entered into for post mortem tax planning purposes. The present matter passes all four tests.

The legal claim brought by the lineal descendants was the mental incapacity of the Decedent, Lester Gardiner, Sr., at the time he executed the Beneficiary Form. Incapacity is a recognized claim in the State of Iowa. *In re Estate of Faris*, 159 N.W.2d 417, 420 (Iowa 1968); *Fairbank State Bank*, 723 N.W.2d 449 (Iowa Ct. App. 2006); *Matter of Guardianship of Collins*, 327 N.W.2d 230, 233 (Iowa 1982). Iowa law treats a transfer on death beneficiary form as a contract, rather than a testamentary transfer. As such, the Beneficiary Form is subject to contract defenses, including lack of mental capacity. Iowa Code § 633.810(1) (2003). The Decedent's estate, on behalf of Descendant's lineal descendants, believed strongly enough in their legal rights to the Accounts that they initiated a lawsuit in Dallas County District Court and conducted discovery, including acquiring a medical opinion from Dr. Robert Bender of the Johnny and Ronnie Orr Memory Center (App. 63-64). The Taxpayer, having read the opinion of Dr. Robert Bender (App. 63-64) opining that the Decedent lacked mental capacity to name her beneficiary of the Accounts, and being unable to find a medical opinion to the contrary (Beverly's Testimony, App. 38-53), reasonably believed that the Decedent's



lineal descendants had an enforceable legal claim to the Accounts. Neither *Hubert* nor the Iowa Supreme Court requires that the *enforceable legal right* in question be fully litigated. *Van Duzer* at 410 (noting that enforceable legal right need only have “merit”). There is no question that mental incapacity cause of action in the lawsuit filed by the Decedent’s estate against Taxpayer had merit.

The Taxpayer is the stepmother of the lineal descendants and they were adversarial in this matter. The Taxpayer and the lineal descendants hired separate lawyers and separate expert witnesses. The lineal descendants' expert witness, noted geriatric physician Dr. Robert Bender, opined that the Decedent suffered from “severe dementia” and was “incapable of understanding his finances.” (App. 63-64). Taxpayer sought to obtain an expert, Dr. Michael Taylor, a psychiatrist to opine to the contrary. Dr. Taylor was unable to do so. (App. 65-68).

The FSA was entered into in good faith. There was a genuine dispute at best as to whether the Decedent was capable of executing a change of beneficiary form at age 92, given his mental condition. The Taxpayer was faced with losing the entire investment securities accounts (the "Accounts") based on the testimony of Dr. Robert Bender. The Taxpayer negotiated the FSA that allowed her to keep half of the Accounts. The negotiations were handled through their respective attorneys and were based solely on the merit of the mental incapacity claim.

The Taxpayer and the lineal descendants were adverse to each other; the tax consequences were not a factor in their negotiations.

### **CONCLUSION**

The District Court erred by ruling that a post-mortem family settlement agreement can never dictate Iowa inheritance consequences. The Iowa Supreme Court in *In Estate of Van Duzer*, 369 N.W.2d 407 (Iowa 1985) clearly states that a post-mortem family settlement agreement can dictate inheritance tax consequences.

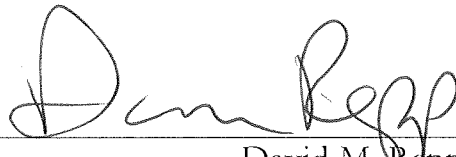
The District Court erred by ruling that the Decedent's estate (essentially, the Decedent's lineal descendants) did not have an enforceable legal right to the Accounts. In fact, Iowa case law is clear that the Decedent's estate had a very strong mental incapacity cause of action against the Taxpayer.

The Iowa Supreme Court should adopt the standards espoused by *Estate of Hubert v. Commissioner*, 101 T.C. 314, 319 (1993) in determining when post-mortem family settlement agreements should dictate inheritance tax consequences.

For these reasons, Appellant requests that the District Court be reversed.

### **REQUEST FOR ORAL ARGUMENT**

Appellant hereby requests to be heard in oral argument upon submission of this cause to the Supreme Court.



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### **CERTIFICATE OF COMPLIANCE**

The undersigned certifies that the Brief and Argument complies with the typeface requirements of Iowa R. App. P. 6.903(1)(e). This Final Brief and Argument has been prepared in a proportionally spaced typeface and created in font Times New Roman 12. The number of words is 4,135.

  
\_\_\_\_\_  
David M. Repp

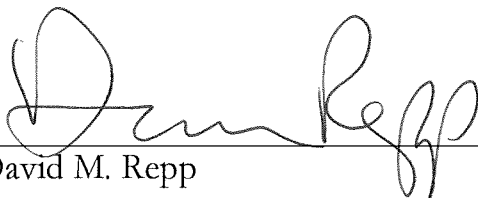
## CERTIFICATE OF SERVICE AND FILING

I hereby certify that on March 14, 2017, I electronically filed the foregoing document with the Clerk of the Supreme Court by using the Iowa Judicial Branch Appellate Courts electronic filing system which will send a notice of electronic filing to the following:

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